ORIGINAL FILE

Sprint

1850 M Street, N.W., 11th Floor
Washington, D.C. 20036
Telephone: (202) 828-7453

Jay C. Keithley
Vice President
Law and External Affairs
United Telephone Companies

RECEIVED

'SEP 1 1 1992

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

September 11, 1992

Ms. Donna R. Searcy
Secretary
Federal Communications Commission
1919 M Street, N.W.
Room 222
Washington, D.C. 20554

RE: In the Matter of Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Process
CC Docket No. 92-133

Dear Ms. Searcy,

Attached are the original and five copies of the Comments of the United Telephone Companies in the proceeding referenced above.

Sincerely,

Jay C. Keithley

Jay C. Keithley
Vice President
Law and External Affairs

Attachments

JCK/mlm

No. of Copies rec'd O + 5
List A B C D E

RECEIVED

SEP 1 1 1992

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Process	)	CC Docket No. 92-133

COMMENTS OF THE UNITED TELEPHONE COMPANIES

Respectfully submitted,

UNITED TELEPHONE COMPANIES

Jay C. Keithley
1850 M Street N.W.
Suite 1100
Washington, DC 20036
(202) 857-1030

W. Richard Morris
P. O. Box 11315
Kansas City, MO 64112
(913) 624-3096

Their Attorneys

September 11, 1992

SUMMARY

United supports the Commission in its drive to reform Part 65. A semi-automatic trigger mechanism reflecting significant and persistent changes in market returns should be adopted. United suggests that the composite BOC capital structure be used as a surrogate for the industry. A cost of equity methodology should not be prescribed.

TABLE OF CONTENTS

RECEIVED

'SEP 1 1 1992

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Process	))))))	CC Docket No. 92-133

COMMENTS OF THE UNITED TELEPHONE COMPANIES

The United Telephone companies[1] ("United") hereby provide their comments in the above-captioned proceeding.[2] United supports the Commission in its "efforts to reduce regulatory burdens by undertaking fundamental reform of . . . rate of return represcription and enforcement processes."[3] These efforts should result in changes to Part 65 that provide stable represcription

---

1. Carolina Telephone and Telegraph Company; United Telephone Company of Southcentral Kansas; United Telephone Company of the Carolinas; United Telephone Company of Florida; United Telephone Company of Indiana, Inc.; United Telephone Company of Eastern Kansas; United Telephone Company of Kansas; United Telephone Company of Minnesota; United Telephone Company of Missouri; United Telephone Company of New Jersey, Inc.; United Telephone Company of the Northwest; United Telephone Company of Ohio; The United Telephone Company of Pennsylvania; United Telephone - Southeast, Inc.; United Telephone Company of Texas, Inc.; and United Telephone Company of the West.

2. In the Matter of Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Process, CC Docket No. 92-133, Notice of Proposed Rulemaking and Order, July 14, 1992 ("NPRM").

3. Id. at Par. 1.

mechanisms and simplified capital structure and cost of debt methodology. Further, flexibility in cost of equity methodology to recognize improvements and innovations in financial analysis, and procedural modifications to streamline the flow of needed information while preserving the due process rights of all parties should be adopted.

I. Rate of Return Represcription Should Occur Only When Meaningful and Persistent Changes Occur in the Financial Marketplace

The current Part 65 procedures call for a represcription proceeding every two years. As past action by the Commission has shown, through deferral of these proceedings, the financial market does not change in lock-step with the two year represcription cycle. Extensions and deferrals of rate of return represcription due to stability in the financial market have proven that a better trigger mechanism for represcription proceedings than the mechanical, biennial requirement of the current Part 65 is needed.

United believes that rate of return represcription should occur only when meaningful and persistent changes occur in the financial market. Some measure of meaningful and persistent change must be developed--a represcription trigger mechanism. Three parts to a trigger mechanism must be developed. First, the data measurement standard for financial market change, second the range within which fluctuation in market activity is not considered significant, and third, the time period over which significant changes must continue before they are recognized as persistent.

Based on these considerations, United recommends the creation of a semi-automatic trigger mechanism that would lead to investigation of whether to proceed with a represcription proceeding at any time when a 150 basis point change either above or below the initial base period level, in the six month average of Aa public utility bond yields, as identified by Moody's, persists for six consecutive months, beginning after the completion of this proceeding. This semi-automatic trigger would act to smooth out short-term volatility in the financial market while also alerting the Commission to changes that should be investigated and might lead to represcription. A data measure reasonably reflecting changes in LEC business and financial risk, Aa public utility bond yields, is appropriate.

United recommends the use of a debt measurement trigger because the cost of common equity has previously proven contentious and is inherently imprecise. In contrast, the cost of debt is closely tracked and readily available. The Aa public utility bond yield can be expected to track LEC capital costs more precisely than government or other industrial bond yield measurements. Because of the stability of this measurement, it is inherently superior to short-term measures that are volatile and quickly reflect governmental and other activities unrelated to the long-term cost of capital.

Under this trigger mechanism, the magnitude and duration of capital market changes that will trigger Commission activity determines the stability of LEC prescriptions. If small yield changes or changes of short duration trigger Commission activity, the LEC represcription will be frequent and the return volatile. The Commission would often be embroiled in a represcription proceeding. For instance, a 100 basis point change persisting over six months would have led to four represcriptions, both up and down, since divestiture while a 150 basis point change persisting over six months would have resulted in one represcription. The Commission has actually represcribed once during this period. United believes that a 150 basis point change persisting over six months is an appropriate trigger that minimizes volatility, best reflects the post-divestiture represcription history, and recognizes the need to reflect changes of significant magnitude and duration in authorized return adjustments.

II. Rate of Return Prescription Should Allow Parties to Use Any Relevant Methodology in Support of Their Position

A. Presumptive or Conclusive Cost of Equity Methodologies Should Be Rejected

The Commission proposes, with the sole exception of "cost of equity" issues, "to adopt methodologies that would be presumptive or conclusive."[4] This standard would be relaxed only if "the record were to show that it would produce unreasonable results."[5]

United believes that the cost of equity analysis methodologies used in represcription review are constantly evolving. Prescribing one cost of equity methodology, for use in the future and prohibiting the consideration of other evolving methodologies, is short-sighted and counterproductive. United asserts that parties should, at their option, be free to provide evidence resulting from the use of alternative cost of equity methodologies. This would result in the Commission having appropriate evidence produced by use of various methodologies. In United's view, the Commission should not presumptively refuse to consider any evidence.

If the Commission were to adopt its proposal to prescribe cost of equity methodologies, it would do little to limit the actual amount of material it receives. Whenever a party was convinced that the prescribed methodology produced inappropriate results, it would file an alternative methodology claiming "unreasonable results" from the prescribed methodology. A failure to consider the alternative methodology, under these circumstances, would likely lead to appeal.

B. The Commission Should Not Prescribe Surrogate Companies for Interstate Access

The Commission should not presumptively adopt a "surrogate" for LEC provision of access service as has been pro-

---

4. Id. at par. 47.

5. Id. at fn. 50.

posed. Over time, the risks inherent in LEC provision of interstate access will change and will not be constant in comparison to any specific surrogate measurement. Thus, parties should be free to propose different surrogate measures that appropriately reflect the risk profile of the provision of interstate access.

The Commission may appropriately require the use of at least one general market surrogate, such as the Standard and Poor's 400. However additional material should be allowed at the discretion of the parties.

C. A Standard Capital Structure Approach Based On BOC Data Should Be Adopted for Use In Represcription Proceedings

In the last represcription proceeding the Commission adopted the capital structure of the Bell Regional Holding Companies ("RHCs") as the appropriate capital structure measure for the industry. United asserts that decision was improper and is now even more improper and inaccurate as RHCs have cellular, international, and other ventures. The problem with RHC data is that it reflects the financial risk inherent in all holding company operations and not those of the LECs alone. For example, considering Bell RHCs and other major holding companies with Tier 1 LEC operations, the S&P Telecommunications Comustat data base indicates that eight holding companies with Tier 1 LECs derive over 20% of their revenue from non-LEC operations. This diversification illustrates the inadequacy of holding company data as a surrogate for appropriate LEC capital structure.

Further, United does not believe that any party has shown any LEC capital structure manipulation by holding companies. To the contrary, LECs have generally structured themselves so that they qualify for A or Aa bond ratings with equity ratios in the high 50% and low 60%. The bond rating reflects the business and financial risk faced by the LEC, including the equity level corresponding to that risk.

In general, the appropriate capital structure that should be used for those carriers participating in a unitary rate of return prescription, should be the actual capital structure of the Bell Operating Companies ("BOCs"). These companies are separate from the holding companies, are limited in number, and have individually offered debt. If the Commission believes that the actual capital structure of the BOCs is departing from a reasonable structure, after reviewing the S&P bond rating criteria, and after receiving appropriate evidence, then the Commission may consider adjustments. Absent such concerns, the BOC capital structure should be used.

While the use of data from all Tier 1 companies is an alternative to the use of BOC only data, United does not support that alternative. If all Tier 1 companies were included in the data collection, the results would not change significantly because of the relative small proportion that non-BOC Tier 1s are to the total and because the non-BOC Tier 1 company's data does not differ markedly from the BOCs. Based on the time and expense involved in this additional data collection, as weighed against its small effect on the overall calculation, United urges the use of BOC only data rather than the data of all Tier 1 LECs.

By creating a rebuttable presumption that BOC capital structures are appropriate as a surrogate, LEC capital structures will be provided enough flexibility for LECs to retain an appropriate debt rating in relation to the business and financial risk of the industry. The use of BOC data will minimize the total data that needs to be compiled and will appropriately simplify the process.

III. Form M Data Should Be Used in Calculating Capital Structure and Debt Cost

Form M provides readily available data to the Commission. This BOC data should be used in calculating capital structure and the cost of debt for the debt category. Schedule B-1, Rows 420, 1407, 4020, 4050, 4060, 4260, and 4270 should be used along with Schedule I-1, Rows 7510, 7520 and 7530. For preferred stock, should BOCs issue any, and common equity, Schedule B-1, Row 440 and Schedule B-14 should be used.

A surrogate for short-term debt costs should also be adopted. An appropriate surrogate is the Federal Reserve Statistical Release G.13 that shows a six-month commercial paper rate.

This cost of debt methodology recognizes the interest method of amortizing debt costs and is consistent with GAAP accounting and the Uniform System of Accounts. Additionally, using Form M as the data source provides the Commission with flexibility to recognize changes in evolving financial analysis.

Form M can also be used to determine the cost of preferred stock. While the BOCs do not currently have such stock, and using them as the basis for capital structure would not recognize preferred stock as a separate capital structure component, if a BOC issues new preferred stock or if a methodology relying on the data of all Tier 1 LECs is used, preferred stock will become an issue. Further, if an individual company proposes company specific adjustments, the Form M approach for that company could again be the basis used because Schedule B 14 shows amount outstanding and dividend rates. A composite rate using this data is easily constructed and it closely tracks real costs.[6]

IV. The Notice and Comment Procedures Proposed Are Not Sufficient

The Commission proposes to use the procedures followed in informal rulemakings in rate of return represcription cases.[7] United asserts these procedures are legally deficient and unfair to the parties. United supports the USTA analysis of the legal

---

6. Form M does not show net proceeds that reflect issuance costs, discounts and premiums. If these items are significant, a carrier proposing a company specific adjustment should be allowed to present evidence on the magnitude of proposed adjustments. Further, the Commission could recognize issuance costs, discounts, and premiums by estimating the average impact of these adjustments to face value to account for average net proceeds.

7. Id. at para. 34.

requirements surrounding a "full opportunity for hearing." In this context, United asserts that the Commission should alter its proposals.

The Commission should recognize that the burden of proof to move from the status quo rests with the party proposing a change. If the Commission proposes to lower the return, it must submit or take evidence that such a move is appropriate.

United does not object to a paper hearing process. While the Commission desires to retain a paper process, it should not exclude the ability to question the accuracy of information or to seek information. Limiting discovery, and thus the ability to probe the basis of the case of other parties, limits the ability to prove the veracity and foundation for statements made in the filings by the parties. Without this discovery, the "facts" will not be established and only potentially unfounded opinions will be available.

While discovery has proven time consuming in previous proceedings, it should not be abandoned. Rather, the procedures surrounding discovery should be improved. For instance, the Commission should provide for the self-executing production of significant background documents. Additionally, questions concerning these documents should be answered. This would reduce the burden on the Commission to act as a discovery choke point, provide access to fundamental documents, and facilitate explanation of potential problems with provided documentation.

CONCLUSION

United supports the Commission in its drive to reform Part 65. A semi-automatic trigger mechanism reflecting significant and persistent changes in market returns should be adopted. United suggests that the composite BOC capital structure be used as a surrogate for the industry. A cost of equity methodology should not be prescribed.

Respectfully submitted,

UNITED TELEPHONE COMPANIES

By Jay C. Keithley

Jay C. Keithley
1850 M Street N.W.
Suite 1100
Washington, DC 20036
(202) 857-1030

W. Richard Morris
P. O. Box 11315
Kansas City, MO 64112
(913) 624-3096

Their Attorneys

September 11, 1992